

REPORT OF EXAMINATION
UNIGARD INDEMNITY COMPANY

Bellevue, Washington

December 31, 1996



States Participating

Washington

I hereby certify that the attached Report of Examination shows the financial condition and affairs of UNIGARD INDEMNITY COMPANY of Bellevue, Washington as of December 31, 1996.

JAMES T. ODIORNE, CPA
Deputy Commissioner, Company Supervision
Acting Chief Examiner

Date

UNIGARD INDEMNITY COMPANY

TABLE OF CONTENTS

SALUTATION	1
SCOPE OF EXAMINATION	1
INSTRUCTIONS	2
COMMENTS AND RECOMMENDATIONS.....	3
HISTORY	4
CAPITALIZATION	4
MANAGEMENT.....	5
BOARD OF DIRECTORS.....	5
OFFICERS	6
COMMITTEES.....	6
Executive.....	6
Investment	6
CONFLICT OF INTEREST	6
MINUTES.....	7
AFFILIATED COMPANIES	7
CONTRACTS/SERVICE AGREEMENTS.....	7
INTERNAL SECURITY	9
FIDELITY BONDS	9
OTHER INSURANCE.....	9
INTERNAL CONTROLS.....	9
INTERNAL AUDIT FUNCTION	9
INVESTED ASSET SECURITY.....	9
OFFICERS AND EMPLOYEES WELFARE AND PENSION PLANS.....	9
TERRITORY AND PLAN OF OPERATION.....	10
GROWTH OF COMPANY.....	11
MARKET CONDUCT.....	11
TREATMENT OF POLICYHOLDERS	11
REINSURANCE.....	12
ACCOUNTING RECORDS AND SYSTEMS	14
ACCOUNTS AND RECORDS	14
ACTUARIAL OPINION	14
SUBSEQUENT EVENTS	15
COMMENTS ON RECOMMENDATIONS FROM PREVIOUS EXAMINATION	15

UNIGARD INDEMNITY COMPANY

FINANCIAL STATEMENTS	15
BALANCE SHEET	16
STATEMENT OF INCOME	17
COMPARATIVE BALANCE SHEET	18
COMPARATIVE STATEMENT OF INCOME	19
COMPARATIVE CAPITAL AND SURPLUS	19
NOTES TO FINANCIAL STATEMENTS	20
COMMENTS ON FINANCIAL STATEMENTS	21
ACKNOWLEDGMENT	22
AFFIDAVIT	23

UNIGARD INDEMNITY COMPANY

Bellevue, Washington
June 20, 1997

Hon. Josephine W. Musser
Commissioner, Wisconsin Insurance Dept.
Chair, NAIC Financial Condition (EX4) Sub
121 E. Wilson
Madison, Wisconsin 53707-7873

Hon. Marianne K. Burke
Director, Alaska Division of Insurance
NAIC Secretary, Western Zone
P.O. Box 110805
Juneau, Alaska 99811-0805

Hon. Deborah Senn
Commissioner, Washington Insurance Department
Insurance Building
P.O. Box 40255
Olympia, Washington 98504-0255

Dear Commissioners:

In accordance with your instructions and in compliance with the statutory requirements of Chapter 48.03 RCW, an examination was made of the corporate affairs and financial records of

UNIGARD INDEMNITY COMPANY

of

Bellevue, Washington

hereinafter referred to as the "Company" or "UID," at its home office located at 15805 NE 24th Street, Bellevue, Washington 98008-2409.

The Report of Examination is respectfully submitted showing the condition of the Company as of December 31, 1996.

SCOPE OF EXAMINATION

Per RCW 48.03.010, the examination covered the three-year period from January 1, 1993 through December 31, 1995 and was carried forward through December 31, 1996. This is the first examination of UID since its redomestication to Washington effective June 30, 1994. Concurrently, the examiners conducted the examination of the Company's parent, Unigard Insurance Company or "UIC." Occasionally, reference to "the Companies" indicates that the items or discussion is equally applicable to the Unigard Insurance Company and Unigard Indemnity Company. The examiners from the state of North Carolina examined the Company as of December 31, 1992.

The examination followed the statutory requirements contained in the Washington Insurance Laws and the guidelines prescribed in the NAIC Financial Condition Examiner's Handbook. UID's operating procedures and financial records were reviewed as considered necessary to ascertain the financial condition of the Company and conformity with related laws. These matters are discussed in various sections of the report. The examination also included identification and disposition of material transactions and events occurring subsequent to December 31, 1996, and a limited review of market conduct issues.

UNIGARD INDEMNITY COMPANY

INSTRUCTIONS

The examination discovered no violations of Regulation or Law that require instructions to the Company.

UNIGARD INDEMNITY COMPANY

COMMENTS AND RECOMMENDATIONS

The examination developed no comments or recommendations calculated to prevent non-compliance in the future.

UNIGARD INDEMNITY COMPANY

HISTORY

Unigard Indemnity Company, wholly owned subsidiary of the Unigard Insurance Company, was incorporated as Unigard Carolina Insurance Company on November 8, 1972 under the laws of the state of North Carolina. It began business on November 22, 1972. On April 5, 1977, UID adopted its present name. On June 30, 1994, the Company redomesticated from Raleigh, North Carolina to Bellevue, Washington.

All outstanding stock of the Company is owned by UIC which is wholly owned by Unigard, Inc., which was a downstream holding company of Unigard Security Insurance Company (formerly known as Unigard Mutual Insurance Company). Effective September 30, 1984, Unigard Mutual completed a plan of demutualization. It changed its name to Unigard Security Insurance Company (USIC) when Hanseco Insurance Company (owned by John Hancock Property and Casualty Holding Company) acquired USIC. On December 31, 1984, John Hancock Property and Casualty Holding Company obtained ownership of USIC from Hanseco Insurance Company. John Hancock Mutual Life Insurance Company indirectly owned John Hancock Property and Casualty Holding Company (JHPCHC). On August 9, 1990, the transfer of 100% ownership of the Company from Unigard, Inc., to UIC was approved. Effective July 1, 1993, JHPCHC sold to Winterthur U.S. Holdings, Inc., 100% of the stock of USIC's wholly owned subsidiary, Unigard, Inc., and its wholly owned subsidiaries, UIC, the Company, Unigard Service Corporation and Unigard Service Corporation of California. Winterthur U.S. Holdings, Inc. is a wholly owned subsidiary of Winterthur Swiss Insurance Company of Switzerland.

As part of the sale, USIC transferred its continuing operations to UIC by means of a 100% Quota Share Reinsurance Agreement. UIC assumed all of USIC's continuing operations, reserves for losses, loss adjustment expenses and unearned premiums. UIC and the Company entered a Pooling Agreement by which UIC assumes 100% of the direct writings of UID and cedes back to UID 14% of the pooled results.

CAPITALIZATION

The original authorized paid up capital of the Company is \$900,000 consisting of 9,000 shares at \$100 par value each and \$900,000 of contributed surplus. On March 2, 1977, capital was raised to \$3,000,000 and contributed surplus increased by \$2,100,000 through the issuance of additional 21,000 shares at \$100 par value each. On March 5, 1980, the Board approved the repayment of \$1,700,000 paid in surplus to its parent company, thus reducing the paid in and contributed surplus to \$1,300,000.

On December 13, 1994, Unigard Insurance Company, the parent, contributed \$5,000,000 to the Company. This transfer increased gross paid in surplus to \$6,300,000.

Currently, the authorized capital of the Company is \$3,000,000 consisting of 30,000 common shares at \$100 par value each. All authorized shares are outstanding.

UNIGARD INDEMNITY COMPANY

MANAGEMENT

Board of Directors

Article I, Section 1 of the Bylaws state that the business affairs of the Company shall be conducted by a Board of not less than seven (7) nor more than seventeen (17) directors. The directors are to be elected at each annual shareholders' meeting and are to hold office for one year.

The following directors, officers, and committee members are serving the Company as of December 31, 1996:

<u>Directors</u>	<u>Principal Business Affiliation</u>	<u>Residence</u>
Dr. Hans-Rudolf Stucki	Gen. Manager, North America Dept. Winterthur Swiss Insurance Group	Winterthur, Switzerland
Laurence P. O'Connor	Chairman, President & CEO Unigard Insurance Group	Bellevue, WA
Dale E. Abbrederis	Sr. Vice President & CFO Unigard Insurance Group	Bellevue, WA
Mary K. Dawson	Vice President, Personal Lines Unigard Insurance Group	Bellevue, WA
Nelson A. Habenicht	Vice President, Marketing Unigard Insurance Group	Issaquah, WA
Cheryl L. Lang	Vice President, Human Resources Unigard Insurance Group	Redmond, WA
Gordon S. McLaren	Vice President, Commercial Lines Unigard Insurance Group	Redmond, WA
Paul B. Swank	Vice President, Claims Unigard Insurance Group	Issaquah, WA

UNIGARD INDEMNITY COMPANY

Elected Officers

Article I, Section 2 of the Bylaws provide that the following officers of the Company shall be elected by the Board of Directors: Chairman of the Board, President, Executive Vice President, such number of Senior Vice Presidents, and Vice Presidents as the Board may determine, and General Counsel. Section 3 provides that the Chief Executive Officer may from time to time designate a Controller, Treasurer, Secretary and any number of Assistant Vice Presidents and Assistant Secretaries.

Name

Title

Laurence P. O'Connor	Chairman of the Board, President & Chief Executive Officer
Dale E. Abbrederis	Senior Vice President & Chief Financial Officer
Mary K. Dawson	Vice President, Personal Lines
Jerry L. Epler	Vice President & Controller
Nelson A. Habenicht	Vice President, Marketing
Cheryl L. Lang	Vice President, Human Resources
Gordon S. McLaren	Vice President, Commercial Lines
Paul D. Neuss	Vice President, Information Systems
Paul B. Swank	Vice President, Claims
L. Arnold Chatterton	Vice President, Corporate Automation & Agency Management

Appointed Officers

Theodore R. Olson	Treasurer
Catherine E. Jacoy	Secretary
Francis P. Hogan	Assistant Vice President
William M. Clumpner	Assistant Secretary
Meredith L. Lehr	Director of Corporate Legal Affairs and Assistant Vice President
Ann Marie Davis	Assistant Vice President
Norman E. Donelson	Assistant Vice President
Ralph A. Mill	Assistant Vice President
Joan E. Pierce	Assistant Vice President

Section 4 provides that the Board shall appoint from among its members an Executive Committee composed of not less than three (3) members, including the President and the Chairman of the Board. The Executive Committee shall have full power to act for the Board ad interim.

Executive Committee

Dale E. Abbrederis
Laurence P. O'Connor - Chairman
Hans-Rudolf Stucki

Investment Committee

The Investment Committee was discontinued effective February, 1994 when Winterthur acquired Unigard Insurance Group.

UNIGARD INDEMNITY COMPANY

Conflict of Interest

The Company has an established conflict of interest procedure for its directors, officers and exempt employees. Each officer and director submits a signed conflict of interest statement to the Corporate Legal Department on an annual basis. Each exempt employee submits a signed conflict of interest statement to the Corporate Legal Department every three years. Any reported exceptions that might be considered a conflict of interest is reported to the Board of Directors or its Executive Committee. No material exceptions were discovered by this examination.

Minutes

The minutes of the Shareholders, Board of Directors and committees of the Board for the period covered under examination were reviewed. The Board adequately approved investment transactions. The meetings were well attended.

AFFILIATED COMPANIES

The Company's outstanding stock is owned by Unigard Insurance Company, a subsidiary of Unigard, Inc. Ownership of the voting stock of Unigard, Inc., resides with Winterthur U.S. Holdings, Inc., a subsidiary of the Winterthur Swiss Insurance Company of Switzerland. As a member of an insurance Holding Company System, registration statements are required to be filed in accordance with RCW 48.31B.025 and WAC 284-18-300. Winterthur U.S. Holdings, Inc., filed the registration statements for each year under examination on behalf of Unigard Insurance Group.

Contracts/Service Agreements

On and after December 1, 1993, Unigard Insurance Company provides all operating services for the Company with reimbursement pursuant to a Service Agreement between the parties dated January 18, 1994. Prior to December 1, 1993, all the operating functions of the Company were performed by employees of Unigard Security Insurance Company, pursuant to an intercompany service agreement.

Winterthur Reinsurance Corporation of America, an affiliate, provides all the investment services relating to the Company's assets held in a custody account at the Bank of New York pursuant to the Investment Service Agreement/Asset Management Agreement dated December 10, 1993, as amended June 14, 1995, February 13, 1996, and February 20, 1997. The amendments incorporated by reference revised Investment Policy Guidelines approved by the Company's Board of Directors.

The Company's income tax returns have been consolidated with Winterthur U.S. Holdings, Inc., and its subsidiaries shown in Schedule Y of the annual statement beginning with the month of December, 1993. The method of allocation between the Company, Unigard Insurance Company and Unigard, Inc. is subject to a written agreement that was effective December 10, 1993. The terms and conditions of this agreement require an allocation of taxes based upon separate return calculations resulting in a tax charge or refund of not more than the amount each company would have paid or received if it had filed on a separate return basis. If on the basis of separate return calculations, a subsidiary would be entitled to refunds of federal income taxes, Unigard, Inc. will pay to the subsidiary an amount equal to the refunds that the subsidiary would have been entitled to receive from the Internal Revenue Service.

The following organization chart is taken in part from the filed 1996 annual statement:

UNIGARD INDEMNITY COMPANY

(Please refer to report hard copy)

UNIGARD INDEMNITY COMPANY

INTERNAL SECURITY

Fidelity Bonds

Winterthur U.S. Holdings, Inc., the parent, has a Financial Institution Bond policy that includes coverage for its subsidiaries. The aggregate liability covered by the bond is \$10,000,000.

Other Insurance

Property and liability coverages are generally provided through a brokerage firm and are primarily underwritten by an appropriate Unigard company, depending on the risks being underwritten. Coverages written on Unigard policies are covered under Unigard's reinsurance program. Excess coverage and other special needs are provided for and underwritten by insurance companies other than those in the Unigard Group.

Winterthur U.S. Holdings, Inc., also has a program of coverage for its subsidiaries for Professional Liability, Directors and Officers Liability, and Fiduciary Liability insurance.

Internal Controls

The Company retained the firm of Ernst & Young, Certified Public Accountants, to audit its statutory financial statements for the years covered under this examination. The firm issued a report on internal control structure as part of the audits with no material weaknesses noted. The examiners also independently tested internal controls and found no material weaknesses.

Internal Audit Function

The internal audit department for the North American subsidiaries of Winterthur U.S. Holdings, Inc., is located at Republic Financial Services, Inc., in Dallas, Texas and performs various operational audits procedures to support and supplement the audits of the CPA.

Invested Asset Security

Winterthur Reinsurance Corporation of America manages the Company's invested assets held in a custody account at the Bank of New York under an investment service agreement. Examination of the custody agreement with the Bank of New York indicates that proper safeguards are in place to secure the Company's assets.

* Please note: Unigard Indemnity Company does not have any employees. The employees of Unigard Insurance Company provide all operational services for UID. The officers of UID are also officers of UIC and are eligible for benefits under UIC's plans.

UNIGARD INDEMNITY COMPANY

TERRITORY AND PLAN OF OPERATION

The Company was licensed to operate in the following states as of December 31, 1996:

Arizona	California	Colorado
Idaho	Illinois	New York
North Carolina	Ohio	Oregon
South Carolina	Tennessee	Utah
Virginia	Washington	Wisconsin

The Winterthur Swiss Group represents the U.S. based operations of Winterthur Swiss Insurance Company, one of the world's largest multiline insurers offering a full array of insurance coverage principally in Europe, North America, Australia and Asia. The group entered the United States in 1936 through the establishment of the United States Branch of the Winterthur Swiss Insurance Company of Winterthur, Switzerland. The parent company, founded in 1875, is one of the largest insurance companies in Switzerland.

The consolidated operations of the U.S. group contribute approximately 14% of the Switzerland based parent and are integral to their international insurance strategy. The Winterthur Swiss Group(U.S.) consists of 24 insurance subsidiaries that provide a complete array of property/casualty and life/health products. Property/casualty products are offered by six distinct regional, multiline business units that operate independently of one another. A.M. Best assigns six ratings units as follows:

The first rating unit is based on the consolidation of General Casualty Company of Wisconsin and three affiliates that pool with it. This operation, which generates 33% of Winterthur Swiss' property/casualty net premiums in the U.S., writes a balanced book of personal lines and mainstream commercial lines business largely in the Midwest.

The second rating unit is based on the consolidation of Republic Insurance Company and its seven affiliates that fully reinsure with it. This group, which generates 16% of Winterthur Swiss' net premiums, writes personal lines through independent agents, predominantly in its home state of Texas, as well as the surrounding eight state area. Commercial business is written for the U.S. operations of international companies insured by the group's ultimate parent, Winterthur Swiss Insurance Company. A majority of this business is then ceded back to the parent and its foreign subsidiaries.

The third rating unit is based on the operating performance and financial condition of Winterthur Reinsurance Corporation of America, which generates 15% of the Winterthur Swiss Group's net premiums. The company operates as a treaty and facultative reinsurer writing business through brokers, and is among the top fifteen professional reinsurers in the country. The company predominantly underwrites treaty business targeting small-to-medium regional insurers, with approximately 35% of its business generated through a quota share arrangement with the General Casualty Group, an affiliate.

The fourth rating unit is based on the consolidated operating performance and financial condition of Unigard Insurance Company and its subsidiary, UID. The companies, which account for 19% of Winterthur Swiss Group's net premiums, write both commercial and personal lines through independent agents predominantly in the Northwest and Western states.

The fifth rating unit is based on the consolidation of the Southern Guaranty Insurance Company and two subsidiaries that fully reinsure with it, as well as its recently acquired Southern Pilot Group. This operation generates 10% of Winterthur Swiss' property/casualty net premiums by writing homeowners, personal auto, commercial auto and commercial multiple peril insurance primarily in the Southeast.

A sixth rating unit is assigned to Blue Ridge Insurance Group. In 1995, this operation generated approximately 7% of Winterthur Swiss' property/casualty net premium which represents personal lines in the Northeast.

UNIGARD INDEMNITY COMPANY

GROWTH OF COMPANY

The following schedule shows the growth of the Company based on the filed annual statements and the Insurance Department's reports of examination:

<u>Year</u>	<u>Net Premiums Written</u>	<u>Net Losses Paid</u>	<u>Admitted Assets</u>	<u>Surplus as Regards Policyholders</u>
1990	\$ 5,713,463	\$ 975,912	\$16,547,137	\$12,589,695
1991	6,063,164	1,334,135	19,954,311	13,305,734
1992*	6,432,578	4,792,945	19,448,397	13,571,199
1993#	30,280,276	(12,501,022)	61,905,199	13,378,293
1994	35,737,416	20,847,085	69,926,019	20,165,285
1995	36,508,178	22,742,497	72,412,954	21,399,435
1996	35,064,702	23,284,668	72,810,710	22,617,967

*Per Insurance Department Examination

#Result of the sale to Winterthur in 1993

MARKET CONDUCT

The Washington Insurance Department conducted a limited market conduct examination of the Company as of December 31, 1996. The following states conducted full market conduct examinations: California conducted a market conduct examination as of June 9, 1995; North Carolina conducted a market conduct examination as of January 13, 1995, and Illinois conducted a market conduct examination as of December 22, 1995.

The current examination includes a review of personal lines and commercial lines business and the Company's procedures as follows:

Treatment of Policyholders

1. Complaints were resolved reasonably.
2. Response to complaints appears to be timely.
3. Complaint logs appear to be properly used.
4. The Company appears to be in compliance with the requirements of the NAIC model act for complaint recording.

UNIGARD INDEMNITY COMPANY

REINSURANCE

The Company cedes and assumes reinsurance. All reinsurance agreements in effect as of December 31, 1996 were reviewed and the coverage is summarized as follows:

Reinsurance Ceded

The Company and its parent, Unigard Insurance Company, are collectively reinsured under a variety of reinsurance treaties. The following schedule summarizes the Companies' ceded reinsurance treaty coverage in force as of December 31, 1996:

<u>Property</u>	<u>Company Retention</u>	<u>Reinsurers' Limits</u>
First Per Risk Excess	\$ 300,000, subject to \$ 750,000 annual aggregate deductible	\$1,200,000 excess of retention, \$3,600,000 per occurrence
Second Per Risk Excess	\$1,500,000	\$3,500,000 excess of retention, \$10,500,000 per occurrence
First Catastrophe Excess	\$5,000,000	95% of \$7,500,000 excess of retention, ultimate net loss per occurrence
Second Catastrophe Excess	\$12,500,000	95% of \$7,500,000 excess of retention, ultimate net loss per occurrence
Third Catastrophe Excess	\$20,000,000	95% of \$15,000,000 excess of retention, ultimate net loss per occurrence
Fourth Catastrophe Excess	\$35,000,000	95% of \$15,000,000 excess of retention, ultimate net loss per occurrence
Fifth Catastrophe Excess	\$50,000,000	95% of \$20,000,000 excess of retention, ultimate net loss per occurrence
Yacht Excess	\$250,000 Hull \$300,000 P & I	\$1,250,000 Hull } Both excess \$ 700,000 P&I } of retention
<u>Casualty</u>	<u>Company Retention</u>	<u>Reinsurers' Limits</u>
First Excess	\$ 500,000 per occurrence	\$4,500,000 excess \$500,000 per occurrence
Second Excess	\$ 5,000,000 per occurrence	\$5,000,000 excess \$5,000,000 per occurrence
Workers' Compensation (WC)	\$ 5,000,000 per occurrence	\$5,000,000 excess \$5,000,000 per occurrence
Third WC Excess	\$10,000,000 per occurrence	\$10,000,000 excess \$10,000,000

UNIGARD INDEMNITY COMPANY

		per occurrence
Fourth WC Excess	\$20,000,000 per occurrence	\$42,500,000 excess \$20,000,000 per occurrence
Personal Umbrella Quota Share (QS)	\$ 200,000 (20%)	80% First \$1,000,000 100% Next \$4,000,000
Commercial Umbrella QS,	\$ 150,000 (15%)	85% First \$1,000,000 100% Next \$4,000,000
Minimum Premium, Commercial Umbrella QS, Automatic Facultative	\$ 150,000 (15%)	85% First \$1,000,000 100% Next \$4,000,000
Commercial Umbrella Excess	\$ 5,000,000	\$5,000,000 excess \$5,000,000

Reinsurance Assumed

The Company's reinsurance assumed is derived primarily from the participants in the intercompany pooling arrangement.

Unigard Indemnity Company, which is part of the intercompany pooling agreement that became effective July 1, 1993, agreed to cede automatically to Unigard Insurance Company from inception all gross liabilities incurred under or in connection with all contracts and policies of insurance issued by the subsidiary. Unigard Insurance Company then retrocedes 14% of this business to Unigard Indemnity Company.

Unigard Security Insurance Company and Winterthur U.S. Holdings, Inc., entered into a stock purchase agreement as of September 24, 1993, which provided for the sale of all the capital stock of Unigard, Inc., the holder of all the issued and outstanding capital stock of Unigard Insurance Company (holder of all the issued and outstanding capital stock of Unigard Indemnity Company).

Under the terms of the Stock Purchase Agreement, the Company and Unigard Insurance Company entered into a 100% quota share agreement with Unigard Security Insurance Company as of December 10, 1993. UIC agreed to assume "on the terms and conditions and for considerations hereinafter contained, a 100% Quota Share of the Ceding Company's, i.e. Unigard Security Insurance Company's, insurance liabilities and obligations, after reduction for collectible Third Party Reinsurance, and all risks, past, present and future with respect to all business conducted or to be conducted by the Ceding Company . . . but excluding the Excluded Business (the "Business Covered")". Amendment Number One dated December 31, 1996 states that the agreement "shall continue in full force and effect through December 31, 1997. The parties agree that the Ceding Company will not write any new business after December 31, 1996".

UNIGARD INDEMNITY COMPANY

Intercompany Pooling Agreement

This agreement was made and became effective July 1, 1993 between the Company and Unigard Insurance Company, its parent. "The reinsurance provided under this agreement was made as part of an intra-group pooling agreement between affiliated companies and is in excess of any third party reinsurance available to either company". UIC agreed to reinsure and assume, and the Company agreed to cede automatically from inception, all gross liabilities of UID incurred under or in connection with all contracts and policies of insurance issued by UID.

UID and UIC agreed that all reinsurance ceded to third party reinsurers should be ceded by UIC. Within this pooling agreement UIC retains 86% of the "pooled" business and cedes, and/or retro-cedes, 14% to UID.

The Company appears to be in compliance with the Washington Insurance Code and NAIC guidelines regarding authorized and unauthorized reinsurers. The agreements include an insolvency clause in compliance with RCW 48.12.160(2).

ACCOUNTING RECORDS AND PROCEDURES

Accounting Records

The Company's accounting functions are processed by UIC through an accounting software for mainframe computers marketed by McCormick & Dodge and operated on UIC's computer located at its home office in Bellevue, Washington. Accounting services are also provided by UIC through the same program under separate Service Agreements with affiliated and formerly affiliated companies: Unigard, Inc., Unigard Security Insurance Company, Wincorp, Inc., (a Washington corporation) and Wincorp, Inc. (a California corporation).

Companies' data is entered into the same general ledger program with an identifying company code for separation of each company's data. The general ledger is maintained on the GL: M system. This system produces a trial balance that is downloaded to a Lotus Spreadsheet for financial reporting. The FREEDOM software is used to prepare the financial pages and exhibits of the NAIC annual statement. Investment accounting for marketable securities is performed using SUNGARD a PC based software package. This system produces the NAIC annual statement investment schedules. Supporting details are recorded in the subsidiary ledgers, journals, and tabulations maintained by the Company's accounting department.

The Company's accounting procedures, internal controls and transaction cycles were reviewed during the planning phase of the examination and a trial balance prepared for the year ended December 31, 1996.

Actuarial Opinion

The actuarial staff of the Insurance Commissioner's Office reviewed the reserves for the combined companies' unpaid loss and loss adjustment expenses. The actuarial staff's estimates indicate that the companies' booked reserves for both losses and allocated loss adjustment expenses are in a reasonable range.

UNIGARD INDEMNITY COMPANY

SUBSEQUENT EVENTS

On June 3, 1997, Unigard Insurance Group announced its plan to build four three-story buildings, each with 45,000 square feet of office space and two levels of underground parking on the 47 acres that is home to its corporate headquarters. One building will be occupied by Unigard, and the rest will be leased to one or more tenants. Construction is scheduled to start early next year, with occupancy of the first building set for late 1998.

COMMENTS ON RECOMMENDATIONS FROM PREVIOUS EXAMINATION

The comments and recommendations made in the last examination were addressed to the satisfaction of the examiners.

FINANCIAL STATEMENTS

The following statements present the financial condition of the Company as of December 31, 1996 as determined by this examination:

UNIGARD INDEMNITY COMPANY

BALANCE SHEET AS OF DECEMBER 31, 1996

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>	<u>Notes</u>
<u>ASSETS</u>				
Bonds	\$63,579,263		\$63,579,263	
Cash on hand and on deposit	8,102,773		8,102,773	
Federal income tax recoverable	193,810		193,810	
Interest, dividends and real estate income due and accrued	934,855		934,855	
Aggregate write-ins for other than invested assets			0	
Total Assets	<u>\$72,810,701</u>	<u>\$0</u>	<u>\$72,810,701</u>	
<u>LIABILITIES</u>				
Losses	\$29,330,513		\$29,330,513	
Loss adjustment expenses	4,586,960		4,586,960	
Contingent commissions and other charges	766,550		766,550	
Other expenses (excluding taxes, licenses & fees)			0	
Taxes, licenses & fees (excl. fed. inc. tax)	158,234		158,234	
Fed. and foreign inc. taxes (excl. def. taxes)			0	
Unearned premiums	14,501,354		14,501,354	
Excess of statutory reserves over statement reserves	277,000		277,000	
Payable to parent, subsidiaries and affiliates	271,784		271,784	
Aggregate write-ins for liabilities	300,339		300,339	
Total liabilities	<u>50,192,734</u>	<u>0</u>	<u>50,192,734</u>	
<u>SURPLUS AND OTHER FUNDS</u>				
Common capital stock	3,000,000		3,000,000	
Gross paid in and contributed surplus	6,300,000		6,300,000	
Unassigned funds (surplus)	13,317,967		13,317,967	
Surplus as regards policyholders	22,617,967	0	22,617,967	
Total liabilities, surplus and other funds	<u>\$72,810,701</u>	<u>\$0</u>	<u>\$72,810,701</u>	

UNIGARD INDEMNITY COMPANY

STATEMENT OF INCOME YEAR ENDED DECEMBER 31, 1996

	BALANCE PER COMPANY	EXAMINATION ADJUSTMENTS	BALANCE PER EXAMINATION	Notes
<u>UNDERWRITING INCOME</u>				
Premiums earned	<u>\$35,135,899</u>		<u>\$35,135,899</u>	
DEDUCTIONS:				
Losses incurred	24,022,645		24,022,645	
Loss expenses incurred	3,191,687		3,191,687	
Other underwriting expenses incurred	10,503,373		10,503,373	
Total underwriting deductions	<u>37,717,705</u>	<u>0</u>	<u>37,717,705</u>	
Net underwriting gain or (loss)	<u>(2,581,806)</u>	<u>0</u>	<u>(2,581,806)</u>	
<u>INVESTMENT INCOME</u>				
Net Investment Income earned	3,842,678		3,842,678	
Net realized capital gains or (losses)	459,344		459,344	
Net investment income gain or (loss)	<u>4,302,022</u>	<u>0</u>	<u>4,302,022</u>	
Net income before dividends to policyholders and before federal and foreign income taxes	1,720,216	0	1,720,216	
Dividends to policyholders	<u>133,694</u>		<u>133,694</u>	
Net income before federal and foreign income taxes	1,586,522	0	1,586,522	
Federal and foreign income taxes incurred	209,990		209,990	
Net income	<u>\$1,376,532</u>	<u>\$0</u>	<u>\$1,376,532</u>	

CAPITAL AND SURPLUS ACCOUNT AS OF DECEMBER 31, 1996

Surplus as regards policyholders, December 31, previous year	<u>\$21,399,435</u>		<u>\$21,399,435</u>
<u>GAINS AND (LOSSES) IN SURPLUS</u>			
Net income	1,376,532		1,376,532
Change in excess of statutory reserves over statement reserves	(158,000)		(158,000)
Surplus adjustments			0
Changes in surplus	<u>1,218,532</u>	<u>0</u>	<u>1,218,532</u>
Surplus as regards policyholders, December 31, current year	<u>\$22,617,967</u>	<u>\$0</u>	<u>\$22,617,967</u>

UNIGARD INDEMNITY COMPANY

COMPARATIVE BALANCE SHEET AS OF DECEMBER 31,

	<u>1996</u>	<u>1995</u>
<u>ASSETS</u>		
Bonds	\$63,579,263	\$63,399,630
Cash on hand and on deposit	8,102,773	7,181,240
Federal income tax recoverable	193,810	
Interest, dividends and real estate income due and accrued	934,855	1,531,745
Aggregate write-ins for other than invested assets	0	300,339
Total Assets	<u>\$72,810,701</u>	<u>\$72,412,954</u>
<u>LIABILITIES</u>		
Losses	\$29,330,513	\$28,592,538
Loss adjustment expenses	4,586,960	5,485,200
Contingent commissions and other charges	766,550	565,841
Other expenses (excluding taxes, licenses & fees)	0	300,339
Taxes, licenses & fees (excl. fed. inc. tax)	158,234	590,464
Fed. and foreign inc. taxes (excl. def. taxes)	0	34,900
Unearned premiums	14,501,354	14,572,548
Excess of statutory reserves over statement reserves	277,000	119,000
Payable to parent, subsidiaries and affiliates	271,784	452,350
Aggregate write-ins for liabilities	300,339	300,339
Total liabilities	<u>50,192,734</u>	<u>51,013,519</u>
<u>SURPLUS AND OTHER FUNDS</u>		
Common capital stock	3,000,000	3,000,000
Gross paid in and contributed surplus	6,300,000	6,300,000
Unassigned funds (surplus)	13,317,967	12,099,435
Surplus as regards policyholders	<u>22,617,967</u>	<u>21,399,435</u>
Total liabilities, surplus and other funds	<u>\$72,810,701</u>	<u>\$72,412,954</u>

UNIGARD INDEMNITY COMPANY

COMPARATIVE STATEMENT OF INCOME FOR THE YEARS ENDED DECEMBER 31,

	<u>1996</u>	<u>1995</u>
<u>UNDERWRITING INCOME</u>		
Premiums earned	\$35,135,899	\$36,046,131
DEDUCTIONS:		
Losses incurred	24,022,645	23,548,601
Loss expenses incurred	3,191,687	3,547,583
Other underwriting expenses incurred	10,503,373	11,268,203
Total underwriting deductions	37,717,705	38,364,387
Net underwriting gain or (loss)	(2,581,806)	(2,318,256)
<u>INVESTMENT INCOME</u>		
Net Investment Income earned	3,842,678	4,373,505
Net realized capital gains or (losses)	459,344	280,237
Net investment income gain or (loss)	4,302,022	4,653,742
Net income before dividends to policyholders and before federal and foreign income taxes	1,720,216	2,335,486
Dividends to policyholders	133,694	169,493
Net income before federal and foreign income taxes	1,586,522	2,165,993
Federal and foreign income taxes incurred	209,990	812,842
Net income	\$1,376,532	\$1,353,151

COMPARATIVE CAPITAL AND SURPLUS ACCOUNT AS OF DECEMBER 31,

	<u>1996</u>	<u>1995</u>	<u>1994</u>	<u>1993</u>	<u>1992</u>
Surplus as regards policyholders, December 31, previous year	\$21,399,435	\$20,165,284	\$13,378,292	\$13,571,200	\$13,305,735
<u>GAINS AND (LOSSES) IN SURPLUS</u>					
Net income	1,376,532	1,353,151	1,786,992	(192,908)	224,465
Change in excess of statutory reserves over statement reserves	0	(119,000)			41,000
Surplus adjustments	0		5,000,000		
Changes in surplus	1,218,532	1,234,151	6,786,992	(192,908)	265,465
Surplus as regards policyholders, December 31, current year	\$22,617,967	\$21,399,435	\$20,165,284	\$13,378,292	\$13,571,200

UNIGARD INDEMNITY COMPANY

NOTES TO FINANCIAL STATEMENTS

1. Bonds

Bonds, not backed by other loans, are valued at lower of amortized cost or investment value based on the NAIC Valuation of Securities. Discount or premium on bonds is amortized using the effective interest method. For loan-backed bonds, anticipated prepayments at the date of purchase are considered when determining the amortization of discount or premium. There have been no significant changes in estimated cash flows from the original purchase assumptions.

2. Federal Income Tax Allocation

The Company's operations are consolidated with Unigard, Inc., and its subsidiaries, which is included in a consolidated federal income tax return with Winterthur U.S. Holdings, Inc., and all its subsidiaries. The method of allocation of taxes is subject to a written agreement with Unigard, Inc. The allocation of taxes is based upon separate return calculations resulting in a tax charge or refund of not more than the amount each company would have paid or received if it had filed on a separate return basis. If, on the basis of separate return calculations, a subsidiary would be entitled to refunds of federal income taxes, Unigard, Inc., will pay to the subsidiary an amount equal to the refunds due from the Internal Revenue Service.

3. Loss and Loss Adjustment Expense Reserves

These liabilities represent the estimated ultimate net cost of all reported and unreported losses incurred but not paid through the end of the year. The unpaid losses and loss adjustment expenses, which are not discounted except for tabular discounts on workers' compensation claims, and include anticipated salvage and subrogation recoveries, are estimated using individual case-basis valuations and statistical analyses as required by the Insurance Department.

4. Unearned Premiums

The Company's total unearned premium reserve represents the unearned premium liability for all policies in force. At the expiration of an insurance contract or policy, the entire premium has been earned. At any point prior to expiration, the Company is required to establish a pro rata portion of the premium as a liability to cover the remaining policy term.

UNIGARD INDEMNITY COMPANY

COMMENTS ON FINANCIAL STATEMENTS

Bonds

\$63,579,263

The Company's investment in bonds represents 87% of its total admitted assets as of December 31, 1996. The bond portfolio consisted of the following:

<u>Classification</u>	<u>Statement Value</u>	<u>Par Value</u>	<u>Market Value</u>
U.S. Government	\$39,280,103	\$38,950,000	\$38,887,000
Industrial & Misc.	<u>24,299,160</u>	<u>24,000,000</u>	<u>24,972,023</u>
Total	<u>\$63,579,263</u>	<u>\$62,950,000</u>	<u>\$63,859,023</u>

The Company uses the effective yield method to amortize bond premiums and discounts. Premiums and discounts on bonds classified as other than collateralized mortgage obligations are amortized in accordance with the NAIC Annual Statement Instructions manual. Collateralized mortgage obligation bond premiums and discounts are accounted for as prescribed by FASB 91, which requires that amortization be accelerated when prepayments of principal are received. The testing of amortized values to maturity in accordance with the NAIC Examiners Handbook revealed no material differences.

Losses and Loss Adjustment Expenses

\$33,917,473

The Company's combined reserves for unpaid loss and loss adjustment expenses represents 67% of its total liabilities as of December 31, 1996.

The casualty actuarial staff employed by the Insurance Commissioner's Office reviewed the reserves for the combined companies' unpaid loss and loss adjustment expenses. Company personnel provided loss and allocated loss adjustment expense development data by line of business, as well as additional information. Actuarial staff also reviewed actuarial reports prepared by the companies' consulting actuarial firm, Tillinghast, a Towers Perrin Company.

The actuarial staff's estimates indicate that the companies' booked reserves for both losses and allocated loss adjustment expenses are in a reasonable range. Actuarial staff also concludes that the companies' methods of establishing bulk and IBNR reserves, including reserves for unallocated loss adjustment expenses, are reasonable. Therefore, the reserves carried by the companies are accepted as they appear on the companies' 1996 Annual Statements.

UNIGARD INDEMNITY COMPANY

ACKNOWLEDGMENT

The cooperation and assistance of the officers and employees of the Company during the examination are hereby acknowledged.

In addition, Timoteo L. Navaja, CFE, CIE, Examiner in Charge, Peter M. Mendoza, CFE, CIE, Larry A. Omdal, Martin Severeid, CIE and D. Lee Barclay, FCAS, MAAA, Actuary and Joshua Ligosky all from the Office of Insurance Commissioner of the State of Washington, participated in the examination and preparation of this report.

AFFIDAVIT OF EXAMINER IN CHARGE